

# Top 10 *Investor Traps*

Source: North American Securities Administrators Association (NASAA) 2012

## **SECURITIZED LIFE SETTLEMENT CONTRACTS**

Life settlement contracts are investments in the death benefits of insurance policies that insure the lives of unrelated third parties. Legitimate investments in life settlement contracts involve a high degree of risk, and investors may be responsible for routinely paying costly premiums for policies that insure people who outlive their life expectancies. Outside the legitimate offerings, crooks are embracing new schemes to deceive even cautious investors. For example, "securitized" life settlement contracts are increasingly popular investments that combine life settlement contracts with traditional securities, such as bonds that supposedly guarantee a fixed return on a fixed date, regardless of whether the insured outlive their life expectancies. This risk-reducing structure has too often proven fraudulent and left victims with nothing but worthless paper issued by a bonding company that does not maintain sufficient assets to fulfill the guarantee, operates in an unregulated overseas territory or simply does not exist.

## **SECURITIES/INVESTMENT ADVICE OFFERED BY UNLICENSED AGENTS**

There has been a consistent increase in investor complaints regarding salesmen/women unlicensed as securities brokers or as advisers giving investment advice or effecting securities transactions. For example, insurance agents offering securities or investment advice without a securities license have not demonstrated sufficient expertise to legally recommend that an investor liquidate securities holdings in favor of insurance products. Investors are often unaware that their insurance agent may not be licensed to give investment advice, and these recommendations too often turn out to be unsuitable or result in investors placed in under-performing products or those with hidden fees or long lock-up periods. Investors should insist that anytime anyone recommends or suggests any transaction related to an investor's stocks, bonds, mutual funds or other securities holdings, the person must produce a proper license.

## **PROMISSORY NOTES**

Investors have been enticed by the promise of big returns through private, informal loan arrangements, only to then suffer deep losses in unregistered or fraudulent promissory notes. These notes give investors a false sense of security with promises or guarantees of fixed interest rates and safety of principal. However, even legitimate notes carry some risk that the issuers may not be able to meet their obligations. Promissory notes are often pitched as personal loans or short-term business arrangements. Unregistered promissory notes are often covers for Ponzi schemes and other scams. Investors should check with the *N.J. Bureau of Securities* to determine whether a promissory note and the seller/borrower are properly registered.

## **PRIVATE PLACEMENTS**

Investors should be aware that, even in the case of legitimate issuers, private placement offerings are highly illiquid, generally lack transparency and have little regulatory oversight. In the United States, the federal exemption for private placement offerings provided under Rule 506 of Regulation D continues to be abused by criminals. Although properly used by many legitimate issuers, unscrupulous promoters use Rule 506 to cloak an otherwise fraudulent offering in legitimacy.

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## **MIRROR TRADING**

The securities market is constantly evolving to provide investors with new products, different platforms and a variety of choices. The latest evolution is “mirror trading,” which is promoted as an automated trading platform that ensures investors will participate in real-time transactions placed or executed by a skilled and knowledgeable third party. Whenever the third party executes a trade in his or her account, the same trade is mechanically placed on behalf of the investor in the investor’s account. Unscrupulous traders and promoters may use trendy platforms such as mirror trading as a way to launch fraudulent schemes or manipulate markets by misrepresenting the success of their strategies, or concealing their motivations and conflicts of interest.

## **GOLD and PRECIOUS METALS**

Higher precious metal prices and the promise of an ever-appreciating, “tangible” asset have lured unsuspecting investors into a variety of scams. Many recent schemes are variations on old themes: a promoter seeking capital, a long-dormant mine, a full refund plus interest and a stake in the mine. Operators will claim to have special coins or nuggets, or access to special markets for high profits and returns. Despite ubiquitous promises to the contrary, there are no guarantees with gold or precious metals, even in legitimate markets. In the spring of 2011, silver’s value declined by 30 percent in a single three-week period.

## **ENERGY INVESTMENTS**

Swindlers continue to trick investors by using high-pressure marketing tactics and touting the mystique of untapped oil and gas reserves and bountiful returns. Even genuine oil and gas investments bear a high degree of risk. Investors must realize the distinct possibility that they could lose their total investment in legitimate ventures. Energy investments tend to be poor alternatives for retirement accounts and should be avoided by investors who cannot afford to lose their entire investment.

## **DISTRESSED REAL ESTATE SCHEMES**

Investments in distressed real estate have been on the rise with the collapse of the real estate bubble. While many legitimate offerings are tied to real estate, investment pools targeting distressed real estate have become increasingly popular with con artists as well as investors. Investments in properties that are bank-owned, in foreclosure, pending short sales or otherwise in distress carry substantial risks. Like other securities, interests in real estate ventures must be registered with the *N.J. Bureau of Securities*.

## **BOGUS or EXAGGERATED CREDENTIALS**

Misuse of credentials or designations intended to imply special expertise or training in financial advice for senior citizens has been increasing. The *N.J. Bureau of Securities* has encountered salesmen/women with nonexistent law degrees or CPA certificates and expired or nonexistent registrations, who are pitching financial services or products. In every circumstance, investors should press for full disclosure and the meaning behind all designations, and should check with the *N.J. Bureau of Securities* if they have any questions about claimed credentials.

## **AFFINITY FRAUD**

Marketing a fraudulent investment scheme to members of an identifiable group or organization continues to be a highly successful and lucrative practice for Ponzi scheme operators and other fraudsters. A recent national study of Ponzi schemes over the past decade found that one in four were marketed to affinity groups to increase the scheme’s credibility and to build the fraud. The most commonly exploited are the elderly or retired, religious groups and ethnic groups. Investment decisions should be made based on a careful evaluation of the underlying merits rather than common affiliations with the promoter.

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